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In The

Supreme Court of the United States

October Term, 1994

CITIZENS BANK OF MARYLAND,

Petitioner,

v.

DAVID STRUMPF,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

BRIEF OF AMICUS CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH DISTRICT

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QUESTION PRESENTED FOR REVIEW

Whether a bank creditor may refuse a bankrupt depositor's request to withdraw funds pending determination by the bankruptcy court of the bank's setoff rights, without violating the bankruptcy stay under 11 U.S.C. § 362(a).

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I. INTEREST OF THE *AMICUS CURIAE*

Credit Union National Association, Inc. ("CUNA")[1] seeks permission to appear and argue as to the matters

[1] CUNA is the national trade association for credit unions and represents the interests of approximately 90 percent of the more than 12,590 federal and state-chartered credit unions operating in the United States that have approximately 67,000,000 consumer members. CUNA is organized for the purpose of representing and advocating the interests and rights of credit unions.

raised in this bankruptcy appeal as *amicus curiae*. Petitioner and Respondent have consented to CUNA's appearance as *amicus*.

In Citizens Bank of Maryland v. Strumpf, 37 F.3d 155, 157 (4th Cir. 1994), the Court of Appeals for the Fourth Circuit held that the automatic stay of 11 U.S.C. § 362(a) is violated when a depository institution places an administrative hold on a bankruptcy debtor's deposit account, while seeking relief from the automatic stay to exercise its right of setoff. CUNA has an interest in redressing the burden that the Court of Appeals' decision places upon its affiliates: thousands of credit unions chartered under the laws of the United States, and the several states.

Credit unions are fundamentally different from banks. National banks and state-chartered banks are for-profit entities owned by their respective stockholders. Banks are permitted to accept deposits from customers (who may or may not be stockholders of the banks). The relationship between a bank and its depositor-customer is a debtor/creditor relationship.[2] The common law right of setoff is applicable to the relationship of a bank and its depositor-customer.[3]

Federal and state-chartered credit unions are member owned, not-for-profit financial cooperatives. Federal credit unions and most state-chartered credit unions do

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[2] The earnings received by the bank depositor-customer are interest.

[3] *See* the authorities and discussion set forth on pages 33 and 34 of the Petition For A Writ of *Certiorari*.

not accept deposits from their member-customers, but rather issue shares in the institution (all member-customers are owners of the credit union).[4] The relationship between such credit unions and their member-customers is an equity relationship, 12 U.S.C. § 1757(6),[5] and not a debtor/creditor relationship. The strict common law right of setoff is not applicable to the relationship between credit unions and their member-customers.[6] Because of this fact, Congress and the states have provided statutory liens that attach to shares owned by member-customers and which secure obligations owing to the credit unions. By enacting the Bankruptcy Code, Congress did not repeal or otherwise limit these liens. In addition, credit unions include in their lending documents consensual liens in which the member-customers grant to the credit unions security interests in the members' shares to secure obligations owing to the credit unions. These liens distinguish the credit union community from other types of lenders whose interests are represented in this case.

Federal and state-chartered credit unions are authorized to make loans to their member-customers, secured

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[4] A few states (Georgia and Kansas) by statute permit state chartered credit unions to accept deposits in addition to offering shares.

[5] The earnings received by the credit unions' member-customers are dividends.

[6] In the few states that permit the acceptance of deposits by credit unions, the strict common law right of setoff does exist, but for the overwhelming majority of federal and state-chartered credit unions the strict common law right of setoff does not exist.

by the shares owned by the member-customers.[7] Many credit unions make these share loans at reduced interest rates and make a number of these loans to member-customers who are marginally creditworthy. These type loans enable member-customers who are marginally creditworthy to obtain credit and to improve their credit ratings. In addition to share loans, many credit unions, like banks, also offer their member-customers credit card accounts secured by their shares in the credit union. These accounts typically have low interest rates, and a number of these accounts are made available to member-customers who are marginally creditworthy. The Court of Appeals' decision in *Strumpf* will have an adverse impact on credit union share-secured lending and secured credit card accounts offered by credit unions to the detriment of consumers who are marginally creditworthy.

Unlike banks, federal credit unions are without statutory restrictions on where they can operate. Many credit unions currently have branches in or do business in more than one state. In fact, federal credit unions have had the ability to engage in interstate credit union operations since the enactment of the Federal Credit Union Act in 1934, 12 U.S.C. § 1751 *et seq*. The Court of Appeals' decision will have an adverse impact on interstate credit union operations, given the diversity of opinions and conflict among the circuits and among the various district and bankruptcy courts.

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[7] Unlike banks, credit unions by statute are permitted to make loans only to their member-customers.

CUNA is in a unique position to address the serious negative consequences of the *Strumpf* holding for federal and state-chartered credit unions as they impact the credit unions' federal and state statutory liens, consensual liens, share-secured loans and secured credit card accounts as well as interstate credit union operations.

II. SUMMARY OF ARGUMENT

The Court of Appeals' decision is contrary to both the language and the policies underlying the Bankruptcy Code as articulated in the Petition for Writ of *Certiorari*. Furthermore, the Court of Appeals erroneously ignored the prerequisite in 11 U.S.C. § 363(c)(2) that the debtor seek bankruptcy court permission prior to using cash collateral in the absence of creditor consent and the further requirement to provide adequate protection to the creditor.

The Court of Appeals' decision effectively deprives federal and state-chartered credit unions (that are fundamentally different from banks) of their federal and state statutory liens (property rights given to them by the Federal Credit Union Act or state statute) as well as consensual liens, in violation of the Takings Clause of the Fifth Amendment to the Constitution.

The Court of Appeals' decision will have the effect of severely restricting or eliminating two types of consumer secured lending that have been sources of credit for consumers who are marginally creditworthy. This conflicts with the purposes of the Federal Credit Union Act.

The *Strumpf* decision will adversely impact the interstate operations of federal credit unions (as well as state-chartered credit unions) which have been empowered by Congress to conduct interstate credit union operations since 1934. This decision accordingly conflicts with another purpose of the Federal Credit Union Act.

The secured rights of credit unions (and banks) must be protected and balanced by the Courts, as intended by Congress. The Court should grant the Petition for Writ of *Certiorari* for the reasons addressed in Petitioner's brief along with the reasons propounded in the *amici* filed by NationsBank, N.A. (Carolinas), NationsBank, N.A. and the First National Bank of Maryland as well as the *amici* filed by the American Bankers Association and by CUNA in order to correct the manifast injustice of the complete loss of collateral protection and to avoid the long-term consequences of inconsistent laws on national lending institutions and on the long-term availability of credit to certain consumer debtors.

III. ARGUMENT

A. The *Strumpf* decision is contrary to both the language and the policies underlying the Bankruptcy Code.

Petitioner's Brief assiduously addresses the arguments in favor of the Court granting the request for hearing the petition. These arguments accurately address the split in authority on the issue of lenders', including credit unions', rights to exercise their security interests as well as state and federal lien rights, in cash on deposit and the gross injustice done to the rights of creditors by

virtue of the Court of Appeals' decision. Petitioner's brief accurately addresses the Court of Appeals' failure to consider the interplay between the following sections of the Bankruptcy Code:[8] 11 U.S.C. §§ 362(a)(7), 542(b), 363(a), 506(a) and 553. The Court of Appeals only considered 11 U.S.C. § 362. This failure to consider the interplay among all of the statutes of the Bankruptcy Code constitutes reversible error.

In adopting and incorporating Petitioner's argument and those arguments propounded by the other *amici* in this case, CUNA further shows to the Court that the Bankruptcy Code at 11 U.S.C. § 363 requires that a debtor provide adequate protection to a lender prior to being given authorization to use cash collateral. "[C]ash collateral" means cash, . . . deposit accounts, . . . or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest." 11 U.S.C. § 363(a). The debtor may not use cash collateral unless the entity that has an interest in such cash collateral consents; or the court, after notice and hearing, authorizes such use. 11 U.S.C. § 363(c)(2). The plain meaning of this provision is that the bankruptcy court may only allow such use of cash collateral upon the provision of adequate protection to the lender for its interest in the collateral. Strumpf never sought court permission to use the bank's cash collateral and the courts below completely ignored this requirement, which applies to Chapter 13 cases. *See, Dunlap v. Cash America Pawn of Nashville (In re Dunlap)*, 143 B.R. 859 (Bankr. M.D.Tenn. 1992), *rev'd on other grounds*, 158 B.R. 724 (M.D.Tenn. 1993); *Brown v.*

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[8] 11 U.S.C. § 101 *et seq.*

The Evanston Bank (In re Brown), 106 B.R. 546 (Bankr. N.D.Ill. 1989), *rev'd on other grounds*, 126 B.R. 767 (N.D.Ill. 1991); *In re Ingle*, 91 B.R. 27 (Bankr. E.D.Mich. 1988); *In re Ford*, 78 B.R. 729 (Bankr. E.D.Pa. 1987) and *Lee v. Schweiker (In re Lee)*, 25 B.R. 135 (Bankr. E.D.Pa. 1982).

B. The *Strumpf* decision deprives federal and state-chartered credit unions of their statutory and consensual liens without due process in violation of the Fifth Amendment of the Constitution.

The Fifth Amendment of the United States Constitution provides, in part, that "no person shall . . . be deprived of life, liberty, or property without due process of law; nor shall private property be taken for public use, without just compensation."[9] If the Court of Appeals decision in *Strumph* is correct, Congress has, by enacting 11 U.S.C. § 362(a), effected a "taking" through governmental action which goes beyond mere regulation.

The rights of credit unions to intangible property (in the nature of their liens on share accounts) are eviscerated by the Court of Appeals refusal to give effect to the plain meaning of other, interrelated statutes in the Bankruptcy Code, most notably 11 U.S.C. § 363(c)(2). This isolated reading of Section 362(a) without reference to or explanation of the requirements of § 363(c)(2) leads to a "taking" of credit union liens.

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[9] U.S.C.A. Const.Amend. 5.

The applicability of the Taking Clause to intangible properties, such as liens, has historically been dependent upon legal recognition by an independent source of law.[10]

Federal credit unions are governed by federal law, codified at 12 U.S.C. § 1751 *et seq*. Congress has expressly provided these federal credit unions the right to a security interest in funds in members' share accounts at the credit unions, to the extent of loans made. 12 U.S.C. § 1757(11) provides that "A Federal Credit Union . . . shall have power . . . to impress and enforce a lien upon the shares and dividends of any member, to the extent of any loan made to him and any dues or charges payable by him". State-chartered credit unions are likewise given special statutory liens in almost all of the states. In addition, member-customers of federal and state-chartered credit unions often grant to the credit unions consensual liens on their shares to secure their loan obligations.[11]

Credit union liens are not unlike other intangibles which this Court has found to constitute "property" for the purposes of the Fifth Amendment's Taking Clause.[12]

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[10] *See, e.g., Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 161 (1980).

[11] Furthermore, the common law right of setoff acknowledged by Congress in 11 U.S.C. §§ 542(b) and 553 is likewise a property interest of banks and suffers the same fate under the Court of Appeals' decision.

[12] *See, e.g., Ruckelshaus v. Monsanto, Co.*, 467 U.S. 986 (1984) (trade secrets protected by Taking Clause); *Armstrong v. United States*, 364 U.S. 40, 44, 46 (1960) (materialman's lien provided for under state common law protected); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 596-602 (1935) (real estate lien protected).

Intangibles delineated by statutory or common law as valid property interests have been furnished the shelter of the Taking Clause since the case of *United States v. General Motors, Corp.*,[13] in which this Court interpreted the language of the Taking Clause to encompass those rights related to property, to wit, possession, use and disposition, rather than mere protection of tangible property. Credit union liens share many of the characteristics that this Court has historically considered when addressing the applicability of the protection of the Taking Clause to intangible properties, and are therefore entitled to comparable treatment.

While it is true that this Court has never articulated a brightline test for determining whether a taking will occur as a result of the administration of a statute or regulation, several factors have been recognized as significant to the inquiry.

In *PruneYard Shopping Center v. Robins*,[14] this Court identified numerous factors which would be accounted for in determining whether governmental action has gone beyond "regulation" and effects a "taking." These factors included: "the character of the governmental action, its economic impact, and its interference with reasonable investment-backed expectations." The existence of statutory and consensual liens certainly provide the degree of reasonable investment-backed expectation contemplated by the Court in *PruneYard*.[15] Credit unions have long

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[13] 323 U.S. 373, 377-378 (1945).

[14] 447 U.S. at 83 (1980).

[15] *Id.*

relied upon the validity of the statutory language and consensual agreements in assessing the risk of financial transactions. The explicit assurances provided for in these statutory schemes and private contracts form the basis of a reasonable investment-backed expectation.[16]

The Court of Appeals' decision, therefore, threatens to substantially interfere with the property interests of credit unions. The consequences of the decision will be to trigger countless violations of the Fifth Amendment if not reversed by this Court. The decision will effectuate this outcome by jeopardizing the statutory and consensual liens upon which credit unions depend in order to provide lower-interest financing to consumers of poor or marginal creditworthiness. Absent the authority to freeze an account, the bankrupt debtor is free to withdraw the funds, thus dispossessing the credit union of the dominion and control required by law to enforce the lien.

Hence, the inevitable impact of the Court of Appeals' decision will be to render future implementation of § 362(a) of the Bankruptcy Code[17] an unconstitutional taking. The lower court, in its legal reasoning, disregarded due process considerations in favor of statutory interpretation. This approach ignores the economic

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[16] Actual governmental acquisition of the property in question is not necessary to constitute a taking. In the landmark decision of *Pennsylvania Coal Co. v. Mahon*, this Court focused with equal scrutiny on the deprivation of the former individual owner rather than the transfer of a right or interest to the government or a third party. The divestiture of a credit union's lien rights is exemplary of such hardship.

[17] 11 U.S.C. § 101 *et seq.*

impact the decision will immediately have upon lending institutions and their consumer borrowers.

Furthermore, adequate compensation for such takings has not been provided for in either the Bankruptcy Code[18] or the Federal Credit Union Act.[19] The sole remedy available to the credit union in this situation is to pursue the individual debtor-member, who is shielded by the Bankruptcy Code, itself.

Consequently, credit unions will be equipped with no remedy at law to address such takings.[20] This violates the principles of fairness and equality representative of our judicial process and embodied within the Constitution. The Bankruptcy Code balances and protects the property interests of both debtors and secured creditors as demonstrated in the Petition for Writ of *Certiorari*. This Court can avoid the unconstitutional result reached by the Court of Appeals by reversing the decision and adopting the position articulated by the Petitioner in its Petition for Writ of *Certiorari*.

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[18] 11 U.S.C. § 101 *et seq.*

[19] 12 U.S.C. § 1751 *et seq.*

[20] It is notable that the judicially crafted "public use exception" to the Takings Clause is not applicable to credit union liens. Although property need not be put to use for the general public in order for a taking to fall squarely within the gamut of the public use exception, it is evident that the debtor, alone, is free to consume the capital. See generally, *Berman v. Parker*, 348 U.S. 26 (1957); *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229 (1984). There is no conceivable public nature to such a taking.

C. The *Strumpf* decision will have the effect of severely restricting or eliminating two types of consumer secured lending that have been sources of credit for consumers who are marginally creditworthy, thereby conflicting with the purposes of the Federal Credit Union Act.

A federal credit union is defined as "a cooperative association organized in accordance with the provisions of this chapter for the purpose of promoting thrift among its members and creating a source of credit for provident and productive purposes", 12 U.S.C. § 1752(1). In accordance with their purpose federal credit unions and many state-chartered credit unions offer to their members loans that are secured by a security interest granted by the members in the shares in their share accounts as well as credit card accounts that are secured by the members' shares. Many members who are marginally creditworthy obtain these type loans and credit card accounts from their credit unions. These type loans and credit card accounts enable member-customers who are marginally creditworthy to improve their credit ratings as they are repaid. The Court of Appeals' decision will adversely impact these type loans and credit card accounts. The decision is not just limited to checking accounts and the right of setoff but will apply to any possessory lien held by a credit union or a bank whether created by statute or contract on any type of share or deposit account. The Court of Appeals' decision will force credit unions to curtail lending, even on a share secured basis, to member-customers who are marginally creditworthy. The purpose articulated in the Federal Credit Union Act and quoted above will be thwarted by the Court of Appeals' decision.

The adverse impact the Court of Appeals' decision will have on secured credit card accounts offered by banks and credit unions is sufficiently discussed in the *amicus curiae* brief filed by the American Bankers Association. CUNA supports the position advanced therein as it pertains to the adverse impact of the Court of Appeals' decision on secured credit card accounts.

D. The *Strumpf* decision will further the conflict among jurisdictions that adversely impacts the interstate operations of federal credit unions (as well as state-chartered credit unions).

Federal credit unions have had the ability to engage in interstate credit union operations since the enactment of the Federal Credit Union Act in 1934, 12 U.S.C. § 1752(9). The Court of Appeals' decision will continue the negative impact the conflict among the jurisdictions has had on the interstate operations of credit unions. The arguments set forth in the *amici curiae* brief filed by NationsBank, N.A. (Carolinas), NationsBank, N.A., and the First National Bank of Maryland addressing the adverse impact the Court of Appeals' decision will have on interstate banking also sufficiently address the adverse impact the Court of Appeals' decision will have on interstate credit union operations. CUNA supports the position advanced therein as it pertains to the adverse impact of the Court of Appeals' decision on interstate credit union operations and interstate banking.

IV. CONCLUSION

For these reasons, Credit Union National Association, Inc. respectfully requests that this Court grant the Petition for Writ of *Certiorari*.

Respectfully submitted this 8th day of March, 1995.

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